

ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author: Haynes Analyst: Jeani Brent Bill Number: SB 1430
Related Bills: See Legislative History Telephone: 845-3410 Introduced Date: 02/03/2000
Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Alternative Minimum Tax/Deletes Appreciated Property Contributions as Tax Preference Items

SUMMARY

Under the Personal Income Tax Law (PITL), this bill would eliminate the appreciated property charitable contribution deduction as an item of tax preference. This item was eliminated as a federal alternative minimum tax (AMT) preference item in the Revenue Reconciliation Act of 1993.

EFFECTIVE DATE

As a tax levy, this bill would become effective immediately upon enactment and would apply to taxable years beginning on or after January 1, 2000.

LEGISLATIVE HISTORY

AB 1208 (1999-2000) would conform both the PITL and the Bank and Corporation Tax Law (B&CTL) to the federal repeal of the tax preference treatment of contributions of appreciated property in computing AMT.

AB 1637 (Stats. 1999, Ch. 930) eliminated the tentative minimum tax (TMT) limitation on personal exemption credits by allowing the personal exemption credits to reduce regular tax below tentative minimum tax.

AB 2797 (Stats. 1998, Ch. 322) conformed California law to the Tax Reform Act of 1997 (TRA) change that allows the same depreciable lives used for regular tax purposes to be used for AMT purposes. The act also conformed California law to the Revenue Reconciliation Act of 1993 elimination of the depreciation component of the adjusted current earnings (ACE) adjustment for AMT purposes. Finally, AB 2797 provided that California law does not conform to the federal exemption from AMT for small corporations enacted by the TRA of 1997.

PROGRAM HISTORY/BACKGROUND

Under **prior federal law**, for purposes of computing alternative minimum taxable income, a deduction for charitable contributions of appreciated property was a tax preference item and thus disallowed to the extent that the fair market value of the property exceeded its adjusted basis at the time of the contribution. The federal Revenue Reconciliation Act of 1993 eliminated the treatment of contributions of appreciated property as a tax preference item.

Board Position:

_____ S	_____ NA	_____ NP
_____ SA	_____ O	_____ NAR
_____ N	_____ OUA	_____ X PENDING

Department Director

Date

Alan Hunter for GHG

3/14/00

SPECIFIC FINDINGS

Existing federal and state laws provide for AMT. The AMT was established to ensure that no taxpayers with substantial economic income avoid all tax liability by using exclusions, deductions, and credits (tax preference items). Alternative minimum taxable income (AMTI) is computed by adding back to regular taxable income tax preference items and by making certain adjustments to taxable income. Tax preference and adjustment items are those tax benefits that have been identified as being instrumental in generating tax savings by reducing a taxpayer's taxable income, such as standard and itemized deductions, accelerated cost recovery system (ACRS) depreciation, certain mining costs, depletion, and appreciated property charitable contribution deduction. **State law** provides a personal income AMT rate of 7% and a corporate AMT rate of 6.64%.

Under federal and state laws, in computing regular taxable income, a taxpayer who itemizes deductions generally is allowed to deduct the fair market value of property contributed to a charitable organization, including certain appreciated property donated to a charitable organization. However, in the case of a charitable contribution of inventory or other ordinary income property or short-term capital gain property, the amount of the deduction is limited to the taxpayer's basis in the property. In the case of a charitable contribution of tangible personal property, a taxpayer's deduction is limited to the adjusted basis in the property if the use to which the property is put by the recipient charitable organization is unrelated to its tax-exempt purpose. For most contributions of appreciated property made by corporate taxpayers, the allowable charitable contribution deduction for regular tax is limited to the adjusted basis of the contributed property.

Under **existing state and federal laws**, donations of property may be treated as charitable contributions for purposes of the deduction if the property is contributed to or for the use of a qualified organization (public, private, or governmental), as follows:

- For corporations, the deduction for charitable contributions is limited to 10% of the taxpayer's net income (except as specified). Contributions in excess of 10% may be carried over to the following five succeeding taxable years.
- For individuals, the amount deductible for a contribution of property that has appreciated in value depends upon whether the property is ordinary-income or capital-gain property. Real estate typically is considered capital-gain property. For contributions to certain types of organizations, including governmental units, the maximum allowable deduction is limited to 50% of the taxpayer's adjusted gross income (AGI). In the case of appreciated capital-gain property, the deduction may be limited to 30% of the taxpayer's AGI.

Under federal law, contributions of appreciated property are not treated as tax preference items for purposes of AMT.

Under state law, for purposes of computing AMTI, the amount of any deduction (generally the fair market value) for charitable contributions of appreciated property (real, personal, or intangible) that exceeds the taxpayer's adjusted basis in the property is treated as a tax preference item and is added back to AMTI. In most cases, the B&CTL AMT calculation is not impacted since the allowable charitable contribution deduction for regular tax is limited to the adjusted basis of the contributed property.

This bill would conform the PITL to existing federal law by eliminating the appreciated property charitable contribution deduction as an item of tax preference. As a result, taxpayers filing under the PITL no longer would need to include in their computation of AMTI the amount by which any allowable appreciated property charitable contribution deduction exceeds the taxpayer's adjusted basis in the contributed property.

Policy Consideration

Because the B&CTL contains the same provisions that make the deduction for contributions of appreciated property a tax preference item, the author may wish to include language to eliminate these B&CTL provisions. Amendment 1 would eliminate the current B&CTL provisions.

Implementation Consideration

Implementing this bill would occur during the department's normal annual update.

FISCAL IMPACT

Departmental Costs

This bill would not significantly impact the department's costs.

Tax Revenue Estimate

Revenue losses are estimated as follows:

Fiscal Year Cash Flow Impact Effective January 1, 2000 Enacted after June 30, 2000 (In Millions)		
2000-01	2001-02	2002-02
(\$10)	(\$10)	(\$10)

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

The estimated revenue loss in comparison to related estimates of previous years has been significantly increased. This increase is due to considerable increases in the fair market values associated with the types of assets subject to this tax preference, namely stock and real property.

BOARD POSITION

Pending.

Analyst	Jeani Brent
Telephone #	845-3410
Attorney	Patrick Kusiak

FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO SB 1430
As Introduced February 3, 2000

AMENDMENT 1

On page 7, line 20, after "SEC. 2." insert:

23457. For purposes of this part, Section 57 of the Internal Revenue Code is modified as follows:

(a) Section 57(a)(5) of the Internal Revenue Code, relating to tax-exempt interest, shall not be applicable.

(b) ~~(1) (A) Section 57(a) of the Internal Revenue Code, relating to items of tax preference, is modified to include as an item of tax preference the amount by which the deduction allowable under Section 24357 would be reduced if all capital gain property were taken into account at its adjusted basis.~~

~~(B) For purposes of paragraph (A), "capital gain property" means, with respect to any contribution, any capital asset the sale of which at its fair market value at the time of the contribution would have resulted in gain which would have been long term capital gain. For purposes of this subparagraph, any property that is property used in the trade or business, as defined in Section 1231(b) of the Internal Revenue Code, shall be treated as a capital asset.~~

~~(2)~~ Section 57(a) of the Internal Revenue Code, relating to items of tax preference, is modified to include as an item of tax preference the amount by which the deduction allowable under Section 24348 for the taxable year for a reasonable addition to a reserve for bad debts exceeds the amount that would have been allowable had the taxpayer maintained its bad debt reserve for all taxable years on the basis of actual experience.

(c) Section 57(a)(6) of the Internal Revenue Code, relating to accelerated depreciation or amortization on certain property placed in service before January 1, 1987, is modified to read: With respect to each property as described in Section 1250(c) of the Internal Revenue Code as that provision read on April 1, 1970, the amount by which the deduction allowable for the income year for exhaustion, wear, tear, obsolescence, or amortization exceeds the depreciation deduction which would have been allowable for the income year, had the taxpayer depreciated the property under the straight line method for each income year of its useful life (determined without regard to Section 24354.2 or 24381) for which the taxpayer has held the property.

SEC. 3.